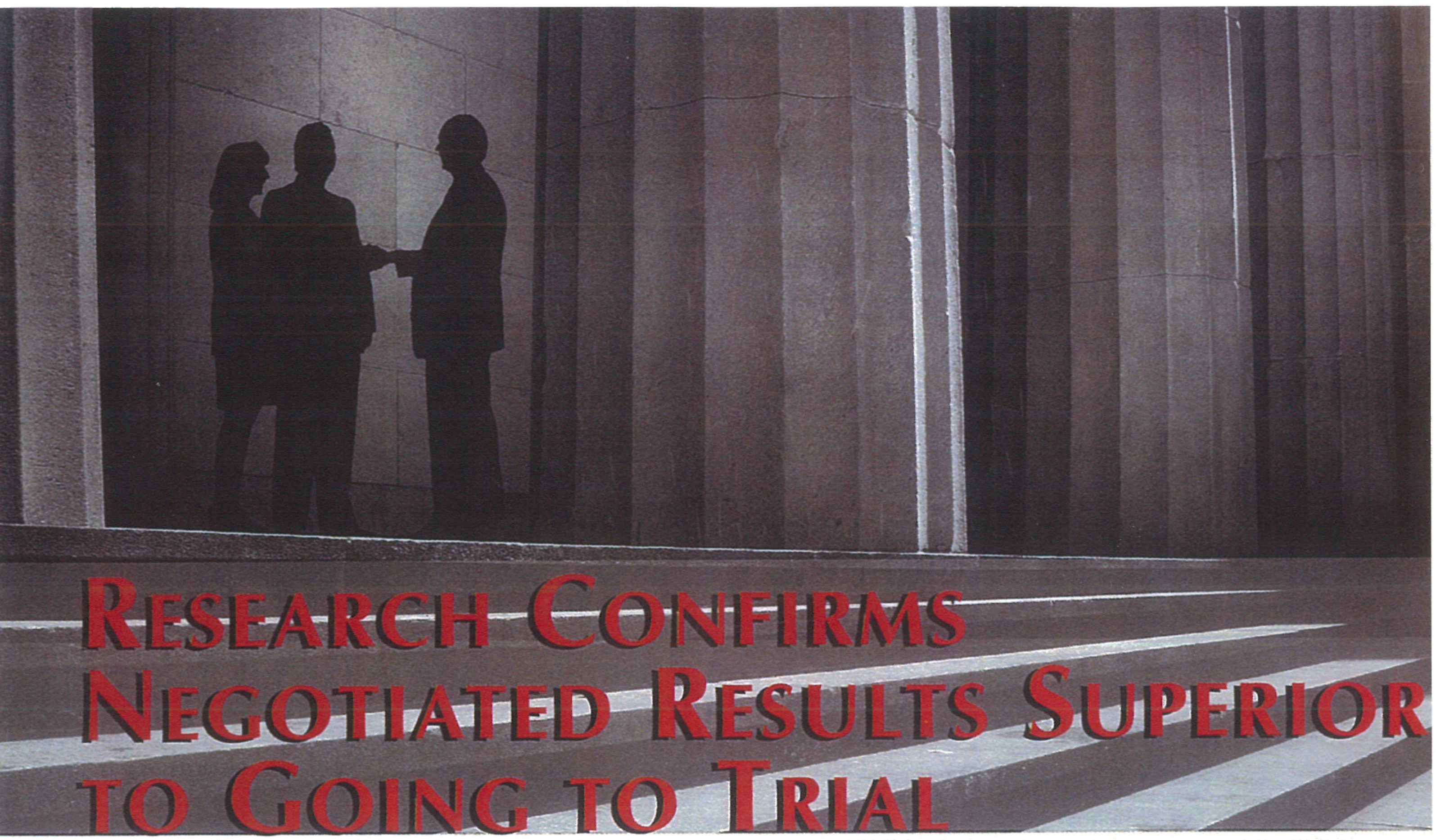

Research Confirms Negotiated Results Superior to Going to Trial

Guy O. Kornblum

A recently published study has provided evidence that indeed a settlement is preferred to trial because the potential result is statistically found to be a better economic result. The study, released in September, reviews the results on a large number of cases that did not settle after mediation and eventually went to trial and how those cases fared in comparison to the last offer or demand.

The September 2008 *Journal of Empirical Legal Studies*,[1] a joint venture of Cornell Law School and the Society of Empirical Studies, has published the results of a quantitative evaluation of "the incidence and magnitude of errors made by attorneys and their clients in unsuccessful settlement negotiations." The study, titled "Let's Not Make a Deal: An Empirical Study of the Decision Making in Unsuccessful Settlement Negotiations,"[2] was written by Randall L. Kiser, Martin A. Asher, and Blakeley B. McShane. The study analyzed 2,054 California cases[3] in which the plaintiffs and defendants participated in settlement negotiations unsuccessfully and proceeded to arbitration or trial and compared the parties' settlement positions with the award or verdict. As the study states, it "reveal[ed] a high incidence of decision-making error by both plaintiffs and defendants in failing to reach a negotiated resolution."[4]

The study actually builds, as is noted below, on prior research in four studies so that the cases analyzed totaled nine thousand in the past forty-four years. It compared the results in selected cases in which the parties exchanged settlement offers, rejected the offers of the other side, and proceeded to trial or arbitration. While the largest group of cases consisted of jury trials, court trials and arbitrations were included. The study was based on the report of results from *California Jury Research* (formerly *California Jury Verdicts Weekly*), which the authors found reliable.

As the study states: "The parties' settlement positions. . . [were] compared with the ultimate award or verdict to determine whether the parties' probability judgments about trial outcomes were economically efficacious, that is, did the parties commit a decision error by rejecting a settlement alternative that would have been the same as or better than the ultimate award."

Prior studies were reviewed and summarized as follows:

- **Priest/Klien (1984–85)**: Trials occur in "close cases," and plaintiffs and defendants equally make mistakes; plaintiffs win about 50 percent of the cases that proceed to trial; this is referred to as the "50 percent implication";
- **Gross/Syverud (1985–86):** The 529 cases from June 1985 to June 1986 that were studied questioned the validity of this type of research because the context of the negotiations and relationship of the parties and counsel affected behavior of the parties;
- **Gross/Syverud (1990–91)**: Here 359 cases were studied, and the results conflicted with the 50 percent distribution of "mistakes"; the authors found plaintiffs were more likely than defendants to reject a settlement opportunity that was more favorable than the result;
- **Rachlinski (1996):** Rachlinski compared final settlement offers with jury awards in 656 cases. His findings were that plaintiffs had a higher percentage of error (56.1 percent of the cases), but the average cost was $27,687, while defendants had a lower error rate (23 percent) but a greater risk of a bad result, with an average cost of $354,000. He concluded that plaintiffs were risk averse while defendants were risk seeking; that is, the risk of trial in these scenarios benefitted plaintiffs but it cost the defendants significantly.[5]

Here is what the researchers found in the September 2008 study:

- Comparing the actual trial results to rejected settlement offers, the study found that 61 percent of the plaintiffs obtained a result that was not economically better than the settlement offer, that is, it was either the same or worse than what was offered;
- In contrast, 24 percent of the defendants obtained a result that was not economically better;
- However, although the plaintiffs experienced more results that were not as economically good as the last offer, the risk of defendants rejecting the last settlement demand was higher;
- Although plaintiffs experienced adverse trial outcomes more frequently than defendants, the financial costs incurred by defendants when they lost their litigation wagers were significantly higher than plaintiffs' costs;
- The average (mean) cost of "decision error"[6] was $43,000 for plaintiffs and $1,140,000 for defendants during the 2002–05 period.

The study also found that the cost of "decision errors" in failing to accept the opportunities to settle increased between 1964 and 2004. In 1964, plaintiffs obtained worse results at trial than were available through settlement in 54 percent of the cases, while in 2004 it rose to 64 percent of the cases. During that same period, the range for defendants went from 19 percent in 1964 to 26 percent in 1984 and then declined to 20 percent in 2004. And the cases in which neither party committed a decision error decreased from 27 percent in 1964 to 14 percent in 2004. Adjusted for inflation, the researchers found that a plaintiff's decision errors increased three times, but a defendant's errors were much more costly—increasing fourteenfold.

Another interesting aspect of the study is the effect statutory offers and cost-shifting procedures had on the eventual results in cases going to a final decision-making process. In California, under Code of Civil Procedure section 998, either party may make an offer of settlement, which, if rejected by the other, can shift certain costs, including those of experts, to the other if the result is less favorable than the statutory offer of judgment.[7] The researchers found that instead of encouraging parties to consider settlement because of the cost shifting consequences of statutory offers, these offers had an opposite effect—instead, the parties were more likely to take aggressive settlement positions, resulting in "financially adverse outcomes," than the other parties in the study. The "decision errors" for plaintiffs who rejected these statutory offers were 83 percent compared to the 61 percent of plaintiffs who were not subject to such. Defendants made "decision errors" in 46 percent of the cases when facing a statutory offer, whereas the rate was 22 percent for defendants who were not faced with such.

Another finding that may not be surprising is that in cases in which litigants were represented by attorneys who had mediation training and experience, the parties experienced lower rates of "decision error." Indeed, plaintiffs in these cases had a "decision error" of 21 percent. The authors suggested more research in this area.

It is quite apparent that the most recent study has dispelled the notion that the "50 percent implication" rule applies. It has established a new dimension of risks of both plaintiffs and defendants in rejecting opportunities to settle. Plaintiffs risk the further costs of litigation and a result that is not that much better, which likely does not justify the investment of time and money in taking a case "to the mat." Defendants, on the other hand, have a huge downside by risking large verdicts against them if they do not appreciate the opportunity they have by a negotiated closure.

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The study's forty-page review of its results is worth careful reading. It may also be important in reviewing the advantages of settlement compared to trial with our clients.

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1. *Journal of Empirical Legal Studies*, Vol. 5, No. 30, pp. 451–491; available online at http://www.blackwellpublishing.com/jels.

2. The study is the subject of an August 8, 2008, article in the *New York Times*, "The Cost of Not Settling a Lawsuit," available at http://www.nytimes.com/2008/08/08/business/08law.html.

3. These were cases in which results were reported in the thirty-eight month period between November 2002 and December 2005. They involved about 20 percent of all California litigation attorneys.

4. The study was an update of three prior studies of attorney/litigant decision making. It increased the number of cases used by three times and expanded on the analytical format and variables of the previous studies. As the study states, "Notwithstanding these enhancements, the incidence and relative cost of the decision-making errors in this study are generally consistent with the three prior empirical studies. . . ."

5. These findings are consistent with the latest study reported here.

6. A "decision error" takes place "when either a plaintiff or a defendant decides to reject an adversary's settlement offer, proceeds to trial and finds that the result at trial is financially the same as or worse than the rejected settlement offer—the 'oops' phenomenon. In absolute terms, the attorney and/or client made a decision error and the client sustained an unequivocal, quantifiable financial loss. [Footnote omitted.] Decision error is strictly a mathematical calculation and does not signify or connote attorney negligence." The authors point out that while the parties may decide to litigate for reasons other than economic ones, noneconomic motives, such as vindication, were rarely mentioned. (Study, p. 563.)

7. See also Rule 68 of the Federal Rules of Civil Procedure, which allows only the party "defending again a claim" to serve an offer of judgment. Both the California code section and the federal rule result in a judgment being entered if the offer is accepted. Not having a judgment "on the books" is a motivation not to accept the offer but instead try to negotiate without that occurring. More often than not, in my experience, the offers are rejected and are served to set up a "cost shifting" mechanism in favor of the party serving such, who anticipates expiration without acceptance.